No. 21929

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CHARLES SELIGSON, Trustee in Bankruptcy of IRA HAUPT & Co., a limited partnership, bankrupt,

Appellant,

vs.

LESTER WILLIAM ROTH,

Appellee.

APPELLEE'S BRIEF.

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APPELLEE'S BRIEF.

I.
PREFATORY STATEMENT.

This trial was bifurcated by stipulation to save the time of the court and enable the parties to present a clear, decisive issue of fact.

The single issue is: Did appellee have reasonable cause to believe that Ira Haupt & Co. (Haupt), and all of its general partners, were insolvent in December 1963 when appellee was paid his then current non-delinquent invoice in the sum of $7,503.95 for legal services rendered? The reasonableness of the fee is not in dispute.

The District Court below found that appellee, then a practicing attorney at law, representing a branch office in Beverly Hills, California, of a large national stock brokerage firm, Ira Haupt & Co., did not have reasonable cause to believe that this firm, and all of its general

partners, were insolvent in December, 1963, when that firm paid to appellee, upon presentation of his then current and non-delinquent invoice for legal services, the sum of $7,503.95 for attorney fees rendered and then being rendered by his law firm. So finding, the Court concluded that the payment was not a voidable preference and entered judgment accordingly in favor of appellee.

The law properly applicable to the facts, as found, is not in dispute.

II.
JURISDICTION.

(a) Jurisdiction in the trial court was conferred by the last sentence of Section 60(b) of the Acts of Congress Relating to Bankruptcy (11 U.S.C. 96). Like jurisdiction is conferred upon the District Court by Section 23 of the Same Act (11 U.S.C.).

(b) Jurisdiction over the instant appeal vests in the Court of Appeals by Section 24 of the said Bankruptcy Act (11 U.S.C. 47, sub (a)).

III.
SUMMARY OF APPELLEE'S ARGUMENT.

1. The trial court's finding is abundantly supported by the evidence and the reasonable inferences that can be drawn therefrom.

2. Appellant failed to offer any evidence to support the indispensable showing that appellee at the time of payment had reasonable cause to believe that the individual general partners of Haupt, a partnership, were also insolvent. No such evidence is in the record. Appellant's position therefore has no substance irrespec-

tive of the disposition of appellee's alleged (but disputed) state of reasonable cause to believe insolvency respecting the financial affairs of Haupt, the partnership firm.

IV.
CONCISE STATEMENT OF THE CASE.

A. The Pleadings and Pre-Trial Proceedings.

(1) Appellant filed a complaint under Section 60(b) of the Bankruptcy Act to set aside, as preferential, a payment made to appellee for attorney fees for services rendered by him to Haupt [C. T. pp. 2-4].

(2) Appellee answered, denying all of the material allegations insofar as they stated a claim to recover an allegedly preferential payment [C. T. pp. 6-7].

(3) The parties stipulated in writing [C. T. p. 56; R. T. p. 11] for a separate trial of the following issue (therein for purpose of brevity called "issue #1"):

> "Did the defendant Lester William Roth have reasonable cause to believe that Ira Haupt & Co., a limited partnership (and all of its general partners) were insolvent on or about December 23, 1963, and at the time when there was paid to said Lester William Roth the sum of $7,503.95 as and for attorney's fees?"

That stipulation further provides:

> "That if this Court decides the said issue #1 in favor of the defendant, that the Court shall then enter judgment in favor of the defendant and against the plaintiff";

and, further:

> "That if the Court shall determine said issue #1 in favor of the plaintiff and against the de-

fendant that then this cause shall proceed to trial, at a later date, on all of the other issues in this cause, counsel then being afforded reasonable time to prepare for the trial of all such other issues." [C. T. p. 56; R. T. p. 11].

(4) A series of 52 written interrogatories [C. T. pp. 47-53] were propounded by appellant to which appellee gave his sworn and detailed answers [C. T. pp. 59-86]. Appellant introduced these interrogatories and answers into evidence at the trial as part of his case against appellee [Pltf. Ex. 2, and R. T. p. 15, line 20, to p. 16, line 9].

B. The Evidence.

It is trite and bromidic to state that in an appeal involving a finding of fact, appellant must show that the finding is clearly erroneous to overcome it. Appellant seeks to meet this burden by taking certain portions of the evidence out of context, which according to appellant indicate that appellee must have known about the liquidation of Haupt; although conceding liquidation does not mean insolvency (p. 16, A.O.B.), and then making argumentative deductions therefrom. Even on this limited ground the law is settled that when evidence is susceptible to an inference from which different conclusions can be reached, the conclusions of the District Court should be accepted (F.R.C.P. 52 (a) and General Order 47, and the decisions of this court in *Security v. Quittner,* 9 Cir., 176 F. 2d 997 and *Hoppe v. Rittenhouse,* 9 Cir., 279 F. 2d 3).

For the convenience of this court, however, we succinctly outline the evidentiary background upon which

the quoted finding is based, even though the burden is upon appellant to show that there is no substantial evidence to sustain the finding. The facts are:

(1) Appellee was practicing law in 1963 in Beverly Hills, California. Admitted to the bar in 1916, he practiced continuously, except for service in the United States Marine Corps in 1917-1918, and service as a Judge of the Superior Court, Los Angeles County, California, from 1931 to 1936. In late November, 1963 he was appointed to the District Court of Appeal and began to wind up his pending law work [see answers to written interrogatories, Pltf. Ex. 2; C. T. p. 60, lines 4-7; and p. 59, lines 28-29].

(2) The circumstances under which he became local counsel for the Beverly Hills Branch Office of Haupt were: In the Spring of 1961, Roth was asked by Lawrence Block and Co. to assist in negotiating a lease for a new building to be constructed in Beverly Hills by Lawrence Block & Co. for occupancy by Haupt as Lessee. The lease generally provided that Haupt pay net rental of $60,000.00 per year and that tenant would equip its new Beverly Hills branch with fixtures costing some $200,000.00 [See Ex. 2, C. T. p. 73, line 23, to p. 74, line 7]. Haupt apparently was highly solvent, and fully responsible therefor. During these negotiations appellee met Joseph Kaufman, general counsel in New York for Haupt, who told Roth that they might need counsel in Beverly Hills, and that he expected to contact Roth later [R. T. p. 31, lines 2-6].

In the Spring of 1963, Roth received a telephone call from Joseph Kaufman [R. T. p. 31, line 6 *et seq.*], inquiring if he (Roth) was interested in becoming

local counsel for Haupt. In Roth's words, the following transpired:

> "At that time he told me that the company was thinking of changing their local representation and asked me if I was interested, and I said yes. He asked me what retainer I wanted and I stated it was a little hard to fix a retainer for I did not know exactly what was entailed. I suggested instead that I do their work beginning with the Spring of 1963 to December of that year, and that then I would render a bill to them for the work I was performing. I told them that I would discuss my bill with them, and that it would be reasonable. I went to work on that basis. Very early in December, 1963, as I recall it, I was advised that I was to be appointed by the Governor to the District Court of Appeal. I then began winding up my work and spoke with the manager of the local company, advising him that the end of the year was approaching, and that I was going on to the Bench, and that I would be sending a bill for services which I was rendering, and that I felt the amount of $7,503.95 to be reasonable. Mr. Blattner agreed, asked that I send the bill in duplicate as indicated hereinbefore, and I did so, and I was promptly paid without challenge of any kind or without any request for extension; all as hereinbefore indicated." [C. T. p. 73, lines 3-22, incl.].

(3) Roth outlined in detail the work he and his law staff performed. No part of that work involved the financial condition of Haupt. None of the litigation brought against Haupt and handled by Roth challenged

even remotely the financial stability of Haupt. None of the suits handled involved any attachments against Haupt [C. T. p. 62, lines 6-8]. None of the suits sought the return of property from Haupt or damages for its failure to return any property [C. T. p. 62, lines 10-12]. The financial problems of Haupt were never discussed by Roth with anyone, nor was he ever consulted with respect thereto [C. T. p. 66, lines 25-28].

Counsel for appellant inquired of Roth in detail as to each particular piece of litigation he handled [C. T. p. 62, line 16, to p. 64, line 15].

Roth was then examined as to each additional item of work listed upon his itemized statement [Exs. 3 and 4]. He testified in detail as to those services, as well [C. T. p. 65, line 22, to p. 66, line 23].

Appellant put the following interrogatories to Roth [C. T. p. 62, lines 6-12]:

Interrogatory No. 18 [Ex. 2]:

> "Q. Did any of the suits which you handled for Ira Haupt & Co. involve attachments? A. No."

Interrogatory No. 19:

> "Q. Did any of the suits seek the return of property or damages for failure to return property. A. No."

Roth testified that he had no conversations in 1963 with anyone in which the financial problems of Haupt were discussed [C. T. p. 70, lines 8-20].

Roth was asked the following question:

> "Q. Did you believe that it was in any difficulty when you had this conversation or presented

your bill? A. I didn't even remotely suspect that it was in financial difficulty." [R. T. p. 40, lines 12-17].

And he was likewise asked [R. T. p. 41, lines 8-12]:

"Q. Did you know anything of your own knowledge concerning that problem with a client of Haupt & Co., this Allied Crude Vegetable Oil Company, of your own knowledge did you do any work in that matter? A. Nothing whatsoever."

Respecting one of the litigated matters, that of *Goorman v. Haupt,* pending and partially, but not finanally, completed when Roth went on the Bench, James P. Del Guercio, a member of Roth's law firm, testified that he completed the Goorman trial in January, 1964 [R. T. p. 55, lines 23-25], shortly after Roth's elevation; won the action for Haupt [R. T. p. 58, lines 13-15], billed Haupt and was paid by Haupt in the regular course of business [R. T. p. 57, line 22, to p. 58, line 6 and Deft. Ex. C]. (This latter payment was made many weeks after the disputed payment of $7,503.95 in December, 1963, which is here involved).

Del Guercio further testified as to a number of other legal matters the office continued to handle for Haupt in the regular course of business long after the disputed payment [R. T. p. 56, line 1, to p. 62, line 5; and see Ex. 1 for continuing law work through February, 1964]. Del Guercio's records showed prompt payment by Haupt for this continuing work after December, 1963, and through March, 1964 [Exs. C and D].

Roth was examined concerning his acquaintance with John Mahoney, liquidator. The record shows the fol-

lowing interrogatories by appellant and answers by appellee Roth [C. T. p. 60, line 23, to p. 61, line 18]:

"INTERROGATORY NO. 9:

"Q. When, if at all, did you first meet James Mahoney? A. Never.

"INTERROGATORY NO. 10:

"Q. Was he at the time you met him acting in the capacity of liquidator for Ira Haupt & Co.? A. I never met or talked to Mr. Mahoney, and I do not know his capacity.

"INTERROGATORY NO. 11:

Q. Did he inform you how long he had been acting as liquidator for Ira Haupt & Co.? A. No.

"INTERROGATORY NO. 12:

"Q. Did he inform you of the reasons for his appointment? A. No."

"INTERROGATORY NO. 13:

"Q. Did he give you any information as to the financial condition of Ira Haupt & Co.? A. No."

"INTERROGATORY NO. 14:

"Q. Did you know that James Mahoney was the Chief Examiner for the New York Stock Exchange? A. No."

"INTERROGATORY NO. 15:

"Q. Did he show or disclose to you any correspondence or documentary evidence pertaining to the financial affairs of the business? A. No."

Roth was examined at the trial concerning the check he received in payment for his statement. The check is the check of Haupt. It is not the check of the liquidator, nor is it signed by or for Haupt by James Ma-

honey [See Ex. 5; R. T. p. 20]. Asked to examine the endorsement on the back of the check, Roth testified that the endorsement was a stamped endorsement placed there by his secretary, who deposited it regularly, and they he hadn't actually ever taken a good look at the check until he was asked at the trial to examine it [R. T. p. 21, lines 15-20]. The check, both front and back, shows its normal deposit and payment, without protest or dishonor and upon presentation [Ex. 5].

Roth was pressed as to his reason for sending a duplicate of his invoice [Exs. 3-4] for his services to James Mahoney, Liquidator. He testified [R. T. p. 34, lines 13-21]:

> "Joseph Kaufman, as I think I testified earlier, asked me to discuss the bill with Mr. Blattner who was their local manager and to obtain his approval of the bill and I did have a conversation with Mr. Blattner, he came to my office, I didn't go to the Haupt office in Beverly Hills, but he came to my office and we had a conversation, and he made the suggestion that I send the statement in duplicate with a copy to, or maybe the original to Mr. Mahoney, the liquidator."

Roth was then examined as to whether or not he had ever read, in 1963, a number of newspaper reports [Exs. 8-A to 8-L], and Roth answered in the negative. These newspaper reports deal with the affairs of Haupt and one of its clients, the Allied Crude Vegetable Oil Co. It appears therefrom that Allied, a customer of Haupt, had become financially involved through the issuance by the American Express Warehouse Company of warehouse receipts purporting to represent salad oil stored in warehouse by the said Allied Crude Vege-

table Oil Co. That commodity had not, in fact, been thus stored in warehouse, albeit, Allied had succeeded in causing American Express Warehouse Co. to issue warehouse receipts therefor which, in turn, were then dealt in on the commodity exchanges by Haupt and other brokers (Williston & Beane). [See Exs. 8-A to 8-L.] Roth said further that he thought (in December, 1963) that because of the difficulties they (Haupt) had with one client (Allied Crude Vegetable Oil Co.) that they had violated some regulation of the New York Stock Exchange and that they were liquidating the business for the purpose of satisfying everybody that it was a solvent concern [[R. T. p. 40, line 18, to p. 41, line 6].

Examined further, Roth testified as follows [R. T. p. 41, lines 8-24]:

> "Q. Did you know anything of your own knowledge concerning that problem with a client of Haupt & Co., this Allied Crude Vegetable Company? Of your own knowledge did you do any work in that matter? A. Nothing whatsoever.
>
> Q. In any litigation that you handled in Los Angeles did any problem arise asserting the alleged insolvency of Ira Haupt & Co.? A. No.
>
> Q. In any matter that you handled for Ira Haupt & Co. was there the assertion that the firm was insolvent? A. No.
>
> Q. Did you have to file any suit or make any threats or demands for payment of this bill? A. None whatsoever. As a matter of fact the bill was paid with surprising promptness."

While Mr. Del Guercio was on the stand he was interrogated about a document found in his file [Ex. 7]

dated November 20, 1963, reading, in applicable part, as follows:

> "Ira Haupt & Co. is solvent and is in an excellent financial position. We anticipate that the suspension by the New York Stock Exchange and the American Stock Exchange is temporary. The Chicago Board of Trade has already removed its earlier suspension."

This statement was issued by a general partner of Haupt, one Kamerman.

Mr. Del Guercio was further examined respecting a letter [Ex. 6] and a telegram dated December 4, 1963 [Ex. A] which he had sent on December 5, 1963 on behalf of the City National Bank for which the Roth Law Office was counsel. A telegram [Ex. A] confirms a concurrent telephone conversation and the telegram reads in part as follows:

> "Confirming our phone conversation of this date you have advised that the present legal status of Ira Haupt & Co. is that 'it is in business', that there are 'no restraining orders or injunctions affecting any activity of Ira Haupt offices.' "

The addressee of that telegram, the law firm of Milbank, Tweed, Hadley & McClory of New York, replied to Exhibit A and Exhibit 6 by letter dated December 7, 1963 [Ex. B]. By that letter, Exhibit B, Mr. Del Guercio was advised that Haupt was "in the process of orderly liquidation, that it is not conducting business in the usual sense, but it remains a business entity while it is closing out its affairs." Exhibit B contains the further statement to Del Guercio: "We know of no restraining orders or injunctions relating to any of Ira Haupt's offices." [Ex. B].

Through Mr. Del Guercio there was then introduced the correspondence with Haupt concerning the continuing legal matters handled by the Roth firm weeks after the payment in December, 1963 of the $7,503.95 [See Ex. D]; and Mr. Del Guercio testified that as late as March 2, 1965, he did law work for Haupt [R. T. p. 56, lines 1-7]; and, that in January, 1964, he completed the then pending Goorman trial [R. T. p. 55, lines 23-25]; worked on the Willebrand matter [R. T. p. 57, lines 1-5]; billed Haupt regularly after December, 1963, and was paid by Haupt [R. T. p. 57, line 7, to p. 58, line 4]. These billings to Haupt, and the admitted payments by it after December, 1963, are now in evidence as Exhibit C.

On the issue of Roth's alleged knowledge in 1963 of the financial affairs of the individual partners of Haupt, Roth testified [R. T. p. 36, line 25, to p. 38, line 16]:

> "Q. Did you ever see a financial statement of the assets and liabilities of the 16 individual general partners of Ira Haupt & Co.?[1] A. I never did.
>
> Q. At any time did you have any cause to suspect that any of the individual general partners of Ira Haupt & Co. were insolvent? A. On the contrary, I knew most of them, not most of them, but at least three of them, to be very wealthy men.
>
> Mr. Katz: Mr. Utley, we can stipulate, can we not, that at least in 1963 there were 16 different general partners of Ira Haupt & Co.?[1]

---

[1]We are told by the case of *In re Haupt & Co.*, 234 F. Supp., at page 158: "Haupt was a limited partnership with sixteen general partners and thirteen limited partners."

Mr. Utley: There were quite a few. I wouldn't be certain as to the number.

Mr. Katz: But there was a substantial number?

Mr. Utley: Put your question.

Q. Were there a number of general partners of Ira Haupt whom you had never even met? A. I would say I haven't met most of them.

Q. Did you have any knowledge as to the assets and liabilities of these general partners in either November or December of 1963? A. No, I did not.

The Court: Do you know who the managing partner was?

The Witness: No."

As against this record, appellant specifically cites testimony of appellee (p. 8, lines 11-16; p. 9, lines 1-9 of his brief) suggesting that appellee indicated reasonable cause to believe insolvency by his testimony that because of a violation by Haupt of a rule of the New York Stock Exchange, Haupt was liquidating to satisfy everyone that it "was a solvent concern". In an earlier statement made by appellee in its opening brief, page 6, line 2, the fallacy of appellant's suggestion is shown by his admission that the bill was actually paid by Haupt, and appellant's evidence showing orderly liquidation.

V.

ARGUMENT ON THE LAW.

1. The General Principles Involved.

(a) There is, of course, a presumption that a payment made by a debtor to his creditor is valid, and a concomitant presumption of the solvency of the debtor.

No invidious inference arises from the fact of such payment, even where made within the four month period described in Section 60(b) of the Bankruptcy Act (*Marshall v. Nevins,* 9 Cir., 242 Fed. 476; 3 Collier on Bankruptcy, 14th Edition, p. 1127). When a debtor pays, and a creditor receives, the amount of a just debt, the natural presumptions are in favor of the good faith of the transaction (*Sabin v. Western,* 9 Cir., 2 F. 2d 130, 131).

(b) The Trustee has the unmistakable burden of proving by a fair preponderance of all the evidence every essential controverted element of an alleged voidable preference (*Keenan v. Shields,* 9 Cir., 241 F. 2d 486), including as a part of that burden that the creditor, at the time of payment (and not months or years later), had reasonable cause then to believe the debtor to be insolvent (*Valley National v. Westover,* 9 Cir., 112 F. 2d 61; 3 Collier 14th Edition, pp. 1123-1127 and case cited; and see *Hoppe v. Rittenhouse,* 279 F. 2d 3).

2. The Trial Court's Determination That There Was No Reasonable Cause to Believe Insolvency Is a Finding of Fact and Not a Conclusion of Law as Asserted by Appellant.

(a) Appellant argues that this Court should disregard the finding of the District Court and make a new finding favorable to appellant. He asks this Court not only to disregard F.R.C.P. 52(a) and General Order 47 in Bankruptcy, but additionally, to disregard, or to reverse a long list of decisions by this Court, including: *First National Bank v. Quittner,* 176 F. 2d 997 (9 Cir.); *Hoppe v. Rittenhouse,* 279 F. 2d 3 (9 Cir.); *Hempy v. Sims,* 246 F. 2d 420 (9 Cir.); *Sabin v. Western,* 2 F. 2d 130; *Cedar Camp Materials v. Bumb,* 344

F. 2d 256 (9 Cir.); and see the host of cases collated in the Treatise, 3 Collier on Bankruptcy, ¶ 60.54, p. 1002, p. 1003 (14th Ed.).

Appellant, realizing that a finding may not be thus disregarded unless bereft of all evidentiary support, then argues secondarily that the District Court's critical finding is indeed a conclusion of law.

The cases are to the contrary. As recently as *Cedar Camp v. Bumb,* 344 F. 2d 256 (9 Cir.), this Court expressly said that the existence of reasonable cause to believe insolvency is an issue of fact. Under General Order 47 this Court must accept a finding on this issue "unless clearly erroneous". *Norberg v. Ryan* (9 Cir.), 193 F. 2d 407, holds that a Trial Court's determination of the issue of reasonable cause to believe insolvency is a finding of fact which is protected by Rule 52(a). The cited cases take their texts from *Security First National Bank v. Quittner,* 176 F. 2d 997 (9 Cir.), at pages 998-999, where the same assertion here made by appellant is discussed, carefully considered, and rejected. This Court said:

> "And if the evidence here be not such as to require us to find the trial court's findings clearly erroneous, we must accept that Court's conclusions. Federal Rule of Civil Procedure rule 52(a), 28 U.S.C.A."

Other pertinent language at pages 998-999 is:

> "In considering the evidence presented, the Court below was confronted with a delicate task. Not much help was available from decided cases which, while very numerous, present widely varying conditions and facts. The creditor cannot be charged

with knowledge, or its equivalent, where a mere ground for suspicion exists. *Grant v. National Bank,* 97 U.S. 80; 24 L. Ed. 971. *He should not be required to make inquiries which could only appear necessary after he had the hindsight of later events.* Due regard must be had for what is common business practice—the standards of the 'prudent business person' should not be unrealistic. *Harrison v. Merchants,* 8 Cir., 124 F.(2) 87."

3. Appellant Misstates the Rule of Law Respecting the Effect to Be Given on Appeal to Facts Below Which Are Essentially Undisputed.

The correct rule in this Circuit is articulated in *Security, supra,* and in *Hoppe v. Rittenhouse,* 276 F. 2d 3, wherein this Court said at page 9:

> "The rule applied in Fazio [*Costello v. Fazio,* 256 F(2) 908] is pertinent where the primary facts can fairly be said to admit of but one reasonable conclusion, and *yet this rule does not change the equally settled rule that where the basic and undisputed facts are fairly susceptible of diverse inferences requiring different conclusions, the determination made by the trier of fact is conclusive on review unless that finding is 'clearly erroneous'.*"

There is an interesting comment on the aforementioned *Fazio* rule and its qualification by the later *Hoppe* case, which is found in *Olympic v. Thyret,* 337 F. 2d at page 68. That comment illumines clearly appellant's error here.

Certainly, and at a minimum, the facts in the case at bar are "fairly susceptible to diverse inferences" and

thus, and contrary to appellant's view, the critical determination by the District Court is one of fact protected by Rule 52(a).

And see also:

Swanson v. Wylie, 237 F. 2d 16, 9 Cir. and cases collated in 4 Remington (Henderson) 334.

4. The Evidence Supports the Trial Court's Finding.

The record amply shows all the following:

(i) The obligation for attorney's fees was paid exactly in accordance with its terms. Appellee's agreement was to act as local counsel for Haupt in Beverly Hills, and to bill it towards the end of the year. Near the end of that year, after he was told by the Governor in late November of his appointment, and a conversation with Haupt's general counsel, Roth sent a bill [C. T. p. 73, lines 3-22].

(ii) The obligation involved was not delinquent; no demand or action of any kind was required to enforce its payment [R. T. p. 41, lines 21-24].

(iii) The check given in payment was the check of the debtor, not the liquidator, was deposited by the payee in the ordinary course of business, and was paid on December 23, 1963, upon its presentation, without protest of any kind [R. T. p. 21, lines 9-20].

(iv) No litigation or other matter which Roth handled for Haupt involved any attachment proceeding against Haupt, nor any effort to recover

property from it, nor any claim that Haupt was insolvent [C. T. p. 62, lines 6-12].[2]

(v) Roth's law staff continued to do work for Haupt, continued to extend credit to Haupt in the form of its labors, and was paid after December 23, 1963 in the normal course of business by Haupt [R. T. p. 55, line 18, to p. 60, line 20].

(vi) Shortly before the challenged payment, in a written statement, the managing partner of Haupt advised the Roth office that Haupt was solvent and while one of its customers, Allied, was in difficulty, Haupt was in excellent financial condition [Ex. 7].[3]

(vii) Shortly before the payment the Roth office was advised telephonically that the legal status of Haupt was that it was in "business" and that there were no restraining orders or injunctions affecting any activity of the Ira Haupt offices [Ex. A].

(viii) Roth never met or talked to James Mahoney, and was never advised respecting his powers

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[2]These facts (i), (ii), (iii) and (iv) are the exact opposite of the facts found in *Security v. Quittner*. These opposite facts in *Security v. Quittner* were enough to support the finding there of reasonable cause to believe. The opposite facts here are enough, by parity of reasoning, to support the opposite finding here.

[3]Appellant misconceives completely the import of this Ex. 7. While it is true that the bankrupt's statement concerning assets and liabilities at a particular time is not conclusive, it is admissible evidence on the issue of the transferee's knowledge or lack of reasonable cause to believe. As is said in the treatise Remington on Bankruptcy, Vol. 4 (Henderson) at p. 278: "The bankrupt's testimony as to his assets and liabilities at any particular time inquired of, is however testimony to facts, and is not to be rejected because uncorroborated."

or duties, nor did the latter give Roth any information respecting the financial condition of Haupt [C. T. p. 60, line 23, to p. 61, line 18].

(ix) Roth testified upon his oath concerning his belief respecting Haupt's financial condition when his bill was presented, and he swore that he didn't even remotely suspect that it was in financial difficulty [R. T. p. 40, lines 13-17]; and "that he knew nothing whatever respecting Haupt's problems with its customer, Allied Crude Vegetable Oil Co." [R. T. p. 41, lines 8-12].

A finding that there was no reasonable cause to believe insolvency was upheld on appeal against similar attacks on evidence less full and convincing than the record at bench, by virtually everyone of our circuit courts. See:

Hempy v. Sims, 9 Cir., 246 F. 2d 420;

Lang v. Houston, 5 Cir., 215 F. 2d 118, particularly at pp. 120-122;

Rogers v. Reconstruction, 6 Cir., 232 F. 2d 930;

McDougal v. Central, 10 Cir., 110 F. 2d 939;

Salter v. Guaranty, 1 Cir., 237 F. 2d 446;

Matter of Machlin, 7 Cir., 4 F. 2d 227; particularly at p. 228.

See also:

Warner v. Citizens Bank, 19 F. 2d 947.

It is settled that the evidence in this case must be weighed by the following rules:

(a) "The trier of the facts, in a suit to avoid a bankruptcy preference, is not required to evaluate the circumstances and incidents involved on the

mere basis of the subsequent failure but may properly appraise the character, purpose and reasonable apparent effect of the transaction at the time that it occurred." *Bostian v. Lavich,* 8 Cir., 134 F. 2d 284.

(b) "In considering the evidence presented, the Court below was confronted with a delicate task. Not much help was available from decided cases which, while very numerous, present widely varying conditions and facts. The creditor cannot be charged with knowledge, or its equivalent, where a mere ground for suspicion exists. *Grant v. National,* 97 U.S. 80. He should not be required to make inquiries which could only appear necessary after he has the hindsight of later events. Due regard must be had for what is common business practice—the standards of the 'prudent business person' should not be unrealistic."

Security v. Quittner, 9 Cir., 176 F. 2d 997.

In spite of the fact that Judge Hall had the witness before him, appellant asks this court to hold the finding of the trier of fact clearly erroneous and to reject the guidelines laid down by the above-cited cases because, says appellant,

(a) Appellee knew there was a liquidator for Haupt in December 1963; and, because (b) appellee should have read a series of articles (but didn't) appearing in the press. Upon these assumptions, he asserts, appellee was charged with the duty of investigation and charged with the consequent knowledge of what appellant now thinks such investigation, if made, might then have revealed. Therefore, appellant argues, this court can

make a finding different from that made by the trial judge. To these assertions and their purported legal effect, we now address ourselves.

5. **Although Appellant Argues That the Knowledge of a Liquidator Should Have Put Appellee on Notice, Appellant's Own Definition of Liquidation Shows, and the Law Is, That Liquidation Cannot Be Equated With Insolvency.**

Appellant Was Not Legally Chargeable, Particularly Under the Circumstances Detailed in the Record, With Notice or With the Obligation to Proceed With Further or Any Investigation.

(a) Countless solvent corporations go into liquidation, voluntarily or involuntarily. Indeed, if appellant were correct, invidious inference would necessarily flow from the liquidation of every firm, however affluent it might be. By appellant's standard, no solvent firm ought ever to go into liquidation, else those who have or continue to deal with it during liquidation and receive payment in due course, must be found to have acted at their peril.

The word "liquidator" is not a synonym for the noun, "receiver". Appellant so concedes (*Cf.* Webster's New International Dictionary, 2nd Edition, Unabridged, where, according to appellant's own brief we find [p. 16, lines 13-17]: "Liquidator—one who liquidates; esp. a person appointed to conduct the winding up of a company. In English law *the liquidator is distinct from the receiver.*") (Italics ours).

Liquidation, according to 54 Corpus Juris Secundum at page 565, "does *not* carry with it the connotation of

insolvency, or that assets are insufficient to pay debts. *Thus a business that is in the process of liquidation may or may not be insolvent and is not presumptively insolvent.*" (Italics ours).

In *Henry v. Alexander,* 194 S.E. 649, the court, dealing with the specific claim that the designation of one as a liquidator for a bank necessarily carried with it the presumption of law that the bank was insolvent when the liquidator was appointed, said:

> "In our opinion these allegations [i.e. that plaintiff was appointed Liquidator of the Commercial Bank of Clinton] *cannot* be considered as making an averment of insolvency; nor does the complaint, viewed in the most liberal light, supply the needed statement of fact. Even solvent banks may be liquidated, and it may be that banks which are considered insolvent may prove to be solvent when liquidated. . . . A business in process of liquidation whether it be that of an individual, a partnership or a banking corporation, may or may not be insolvent. *The term does not necessarily carry with it the connotation of insolvency; nor specifically that the assets of a bank* in process of liquidation are insufficient to pay its debts." (Italics ours).

It should be borne in mind that Roth presented his bill in a most natural manner at the time he was winding up his own work at his law office.

Roth never talked to this liquidator. He never met him. He never learned who had appointed him; or what his duties were [R. T. p. 60, line 23, to p. 61, line 18]. But, says appellant, he should have met him; he should have learned what his duties were. The

record shows that if he had, he would have been told, as Del Guercio was, that Haupt was solvent. Appellant argues, too, that since Roth was representing Haupt's Beverly Hills office, he should have known, as a matter of law, that when Mahoney was appointed in New York that the firm itself was in financial difficulty.

Not so. In today's complex world it is common business practice by local counsel to act for hundreds of national firms without being privy to their national financial situations, or their fiscal affairs. Large national insurance companies engage local counsel to handle their local litigation and local problems. Railroad, large chain stores, etc., etc., use local counsel for their local problems. Can anyone seriously assert that such local counsel must therefore be privy to the nature of their national client's financial affairs? They *might* know. But it does not follow from their localized status that local counsel *do* in fact know, or *should in fact* know or have reasonable cause to believe anything about such national financial condition, especially where, as here, no matter which local counsel had handled, or was handling in the course of the discharge of his services, questioned or even remotely involved the financial condition or solvency of the national client.

We can imagine no more "unrealistic" standard than the one appellant asks this Court to apply when it argues that local counsel, acting for a national firm in liquidation must (as a matter of law and independent of the true facts), be deemed to have reasonable cause to believe insolvency, or that he must, as a matter of law, be deemed to have acted in violation of the standard norms of a prudent business person if without exhaustive investigation he accepts payment in the

regular course of his business of a bill paid by the debtor promptly upon its presentation.

Even if there be some, like appellant, who disagree with these views, still the determination by the District Court here should be upheld by virtue of the rule of this Court respecting different inferences from given facts, and the further rule: "Due regard must be had for what is common business practice—the standards of the 'prudent business person' should not be *unrealistic.*" *Security v. Quittner, supra; Harrison v. Merchants,* 8 Cir., 124 F. 2d 871.

Nor is the case any different simply because Roth said: "I didn't even think, as I tried to reconstruct the picture, that they were voluntarily liquidating the business. I thought that because of the difficulties they had had with one client that they had violated some regulation of the New York Stock Exchange and that they were liquidating the business for the purpose of satisfying everybody that it was a solvent firm." [R. T. p. 40, line 24, to p. 41, line 26.] Appellant makes much of this declaration, even going so far as to suggest that this alone establishes that the determination by the trial court was "clearly erroneous."

Not so. In the first place, this statement is to be read in the light of the following further answers given by Roth on the same subject: At R. T. 47, line 17, counsel for appellant put the following question to appellee (after the latter gave the answer quoted in appellant's brief at p. 9, line 3 thereof):

By Mr. Utley:

"Q. Judge, you spoke of your thought that Ira Haupt & Co. had some difficulty with a client. What client were you referring to? A. By name

> I have heard it in the court room—I can't repeat it now—but it is that client. I had a general understanding that some client had either defrauded them or that they had violated by reason of negligence or something or other the rules of the Stock Exchange and for that reason a liquidator had been appointed, but who appointed the liquidator, when he was appointed, what his functions were, I had no idea then and I have no idea now."

And at R. T. p. 41, line 8, the following was asked of, and answered by, appellee:

> "Q. Did you know anything of your own knowledge concerning that problem with a client of Haupt & Co. this Allied Crude Vegetable Oil Company. Of your own knowledge did you do any work in that matter? A. Nothing whatever."

It is too late in these hectic times to suggest that there is *necessarily* any connection between a large business firm's difficulty either with a client, or with a regulatory agency (public or private) and a reasonable cause to believe in the insolvency of that firm at the time of such involvement. Frequently solvent firms are charged and found guilty of violating regulations of the National Labor Board, the Federal Power Commission, the I.C.C., the Wage and Hour Divisions, the various regulations of Stock Exchanges, etc., etc. Wide publicity often attends such findings.

To suggest that a reasonable person could not, under any circumstances, fail to believe that insolvency existed (and that is the test) when advised of such firm's involvement in such a regulatory violation, is to de-

mand a standard inapplicable to the world, as it exists today. This is the *unrealistic* standard decried by this Court in *Security v. Quittner, supra.*

Appellant urges upon this Court the proposition that the receipt of some information respecting the alleged infraction of a regulation must in all events be deemed the receipt of facts carving out reasonable cause to believe insolvency to exist, and thereby generating the need to make further inquiry, and, in turn, resulting in the penalization of a payee for not making such further inquiry. This proposition is at war with the law and with sound common sense. It would establish for lawyers representing local branch offices of national firms a duty to investigate every rumor coming their way concerning their nationally based client's conduct, even if the rumor involved the client's difficulty with a customer, or the claim that the client had violated some regulatory agency's regulations, or was in liquidation. The lesson of *Grant v. First National,* 97 U.S. 80, is here apposite:

> "It is not enough that a creditor has some cause to suspect the insolvency of his debtor, *but he must have such a knowledge of facts* as to induce a reasonable belief of his debtor's insolvency, in order to invalidate a security taken for his debt." (Italics ours).

Absent such knowledge, no duty to investigate even arises.

And there was no duty in any event to investigate further, in the context of this case.

It is to be remembered that the District Court had the following evidence before it in the form of Exhibit A (that Exhibit A is a telegram sent by James Del

Guercio, a member of appellee's law staff, who was then acting on behalf of yet another client, City National Bank in Beverly Hills, whom the same law office represented; the telegram confirms his telephone conversation on December 5, 1963 with New York counsel for the liquidator).

> "This office is general counsel for City National Bank of Beverly Hills with which bank Ira Haupt & Co. has conducted its banking transactions. Confirming our phone conversation of this date you have advised that the present legal status of Ira Haupt & Co. is that it is in business, that there are no restraining orders or injunctions affecting any activity of Ira Haupt offices."

Nor was this conversation, as reflected in Exhibit A, changed significantly by the letter from New York counsel, Exhibit B, wherein the Roth office was advised: "The firm of Ira Haupt is in the process of orderly liquidation; it is not conducting business as a broker-dealer in the usual sense, but it remains a business entity while it is closing out of its affairs . . ."

Appellant, however, argues that Roth is charged with knowledge of the newspaper reports [Ex. 8-A to L] which he did not read. If read, appellant's case would be no better. For a reading of those reports would reveal a myriad of assertion and cross-assertions such as:

> "Ira Haupt is solvent and in excellent financial condition; Latest Statement shows net worth of $8,343,820 and total assets of $89,260,000.00; Haupt net worth 8.3 million and assets of 89.2 million; Haupt seeking to recover its losses in Court Action; Haupt added 5 new partners [naming them], etc." [See Ex. 8-A-L].

We do not deal here with a "Ponzi" type case (*Lowell v. Brown,* 280 Fed. 193) reversed on other grounds *sub. nom. Cunningham v. Brown,* 265 U.S. 1. Here Roth, if he had in fact read these articles, would have read different rumors about a variety of cross-claims—viz. that while Haupt had been suspended on one day from the New York Stock Exchange, it was reinstated on the following day by the Chicago Stock Exchange; and that Haupt had a net worth at the very time involved of more than eight million dollars [See Exs. 8-A to L].

Helpful here in evaluating the District Court's determination of Roth's conduct is the principle: "He should not be required to make inquiries which could only appear necessary after he has the hindsight of later events." (*Security v. Quittner, supra.*) What Judge Fee said for this Court in *Engleman v. Bengel,* 191 F. 2d at page 689 is here significant:

> "No one could predict when Chemurgy would be bankrupt or even that it would be insolvent. *The exact day upon which this line would be established could not have been divined except by necromancy.*" (Italics ours).

Only those who use hindsight have 20/20 vision. Roth, reasonable man though he is, possessed no occult powers; necromancy was indeed beyond him.

Without the power of divination in December, 1963, Roth, even if he had the duty to investigate (which we dispute), could not have discovered in December, 1963, the insolvency which was determined only by events occurring much much later, and only after a lengthy trial and appeal; and in an insolvency adjudica-

tion brought about by an involuntary petition filed not by any creditors of Haupt, but by three of its limited partners. (See 234 F. Supp. 168).

Appellant's assertedly "invincible" evidence was before the District Court together with all of the evidence. The District Court's finding was a reasonable interpretation thereof. We respectfully assert that for this reviewing Court to hold the District Court's finding clearly erroneous would be to ignore the rules of law applicable to a review of findings of fact.

6. Appellant Misstates the Law Respecting the Effect in the Case at Bar of the Subsequent Adjudication in Bankruptcy.

Appellant seeks to give his position a complexion of soundness by reason of the subsequent adjudication in bankruptcy.

It is axiomatic, of course, that the fact of a subsequent adjudication in bankruptcy is neither binding upon, nor admissible against, the defendant creditor in an action to set aside an allegedly preferential transfer.

In *Gratiot County Bank v. Johnson,* 249 U.S. 247, the U. S. Supreme Court laid down the principle consistently followed ever since that date, that an adjudication in bankruptcy based upon a finding in involuntary proceedings that the debtor had been insolvent for four months or more before the filing of the petition and while so insolvent had made certain preferences, is not conclusive even as against a creditor receiving payments during that period who was not a party to the proceedings and took no part therein. See also, and to like effect, *Liberty Bank v. Bear,* 265 U.S. 362.

And if such an adjudication is not determinative as against such a creditor receiving an alleged preference, even on the issue of insolvency, how conceivably can such an adjudication be any evidence that a creditor charged with receiving such a preference had reasonable cause to believe such insolvency existed at the time of payment? Appellant twists this rule of law out of shape by his arguments here.

Nor is this situation changed in anywise, as argued by appellant, by the portion of the stipulation [C. T. pp. 55-56] [R. T. pp. 10-12] reading as follows [C. T. p. 56]:

> "(4) The parties further stipulate, *merely for the purpose of enabling this Honorable Court to proceed to trial separately on said issue #1,* and without otherwise conceding the fact, that the Court may so proceed with said hearing upon the assumption that Ira Haupt & Co., and all of its general partners, were, in fact, insolvent on December 23, 1963 when the payment of attorney fees in the sum of $7,503.95 was made to Lester Wm. Roth by Ira Haupt & Co., a limited partnership.
>
> "At all other stages of this proceeding, including any trial that may ensue after the determination of issue #1, the burden of proof shall be upon plaintiff to prove the said alleged fact of insolvency."

Obviously the parties desired to have Judge Hall try first and separately and speedily said issue #1, the issue of reasonable cause to believe. But that issue could not be tried first without at least a stipulation that merely for the purpose of hearing issue #1 speedily and separately, that the Court could presume the partnership and the individual partners to have been in-

solvent. The language is crystal clear. There is of course no stipulation that Roth had reasonable cause on December 23, 1963 to believe that fact; and, there is no stipulation that investigation by Roth, if the law required investigation of him, would have resulted on December 23, 1963 in discovery of the fact.

Obviously the express provision of the same stipulation that at all other stages of this plenary suit, including the issue of insolvency, the burden of proof thereon remained with appellant, indicates that the parties by their stipulation were establishing a *modus operandi* to permit the Court to try issue #1 separately. Equally obvious such a methodology was necessary, for, absent evidence of insolvency, the issue of reasonable cause to believe could not even be tried.

7. The Appellant's Failure to Introduce Any Evidence Whatever to Prove That Appellee Had Reasonable Cause to Believe All of the Individual General Partners to Be Insolvent on December 23, 1963, Is in Any Event Fatal to This Appeal.

The separate issue #1 which by express written stipulation of the parties below, the Trial Court was to determine was this:

> "Did the defendant Lester William Roth have reasonable cause to believe that Ira Haupt & Co., a limited partnership (*and all of its general partners*) were insolvent on or about December 23, 1963 and at the time when there was paid to said Lester William Roth the sum of $7,503.95 as and for attorney's fees?" [C. T. p. 55]. (Italics ours.).

That was the issue as defined by the parties. The trustee introduced not one word of testimony suggest-

ing Roth had cause to believe that any one of the 16 general partners of Ira Haupt & Co. was insolvent on December 23, 1963 (Ruth testified that he knew only a few of these general partners of Ira Haupt & Co. & Co. and had no knowledge whatever as to their financial condition, except that those few general partners he had met appeared to be very wealthy men). [R. T. p. 36, line 25, to p. 38, line 16.]

Appellant tells us that when *he* speaks of the insolvency of the partnership Haupt this "obviously includes all of the general partners" (p. 4, lines 1-2 A.O.B.) and, says appellant: "By way of explanation when we speak of the insolvency of Ira Haupt & Co., we are obviously including the insolvency of all general partners, which this Honorable Court has said was essential in order to establish insolvency of a partnership." Thereupon appellant cites *Tom v. Sampsell,* 131 F. 2d 779, as though the principle of that case aided appellant here. Instead, we submit that case is fatal to appellant's position, as a simple reading of it shows; for, *Tom* establishes the principle of the separateness in Bankruptcy proceedings of the partnership entity from the individual partners. In *Tom,* the Court reversed the attempt made by the trustee there to lump the two. Appellant argues for a proposition which this Court rejected in *Tom.*

In this suit, the initial issue was appellee's reasonable cause to believe insolvency on the part of Haupt, a limited partnership, and insolvency on the part of all its general partners on December 23, 1963. *To have such reasonable cause to believe he must have had cause to believe that both the partnership and its general partners, as well, were then insolvent, for knowledge of*

the one, without the other, would not be sufficient. Thus, in 8 A *Corpus Juris Secundum* at page 130, we are told:

> "Knowledge of a creditor of a partnership that the partnership is insolvent, *does not charge such creditor with knowledge, or with reason to believe, that an individual partner is insolvent.*"

In his Treatise on Bankruptcy, Collier (Vol. 3—14th Edition at page 1080) affirms that proposition precisely.

In re Hull, 224 Fed. 796 (D.C. Ohio), is directly in point and follows the cited treatises precisely, for in the *Hull* case the court laid down this principle: "Knowledge of the partnership creditor that the partnership is insolvent, does not charge the creditor with knowledge that an individual partner is insolvent."

Appellant introduced not one word to indicate that Roth had reasonable cause to believe the individual general partners to be insolvent. Roth, on the other hand, offered ample proof to support his belief in their solvency. Absent any contrary proof by the trustee, the District Court properly determined Roth had no reasonable cause to believe the individual partners to be insolvent. And, in that setting, the presumption of solvency which prevails under our law, of course furnished adequate additional support for the District Court's ultimate finding of fact.

For all of the reasons here given we believe the judgment below should be affirmed.

Respectfully submitted,

CHARLES J. KATZ,
Attorney for Appellee.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

CHARLES J. KATZ,